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In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 287

EDWARD McLOUGHLIN, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 13–17) is reported in 34 B. T. A. 963. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 23–30) is reported in 89 F. (2d) 699.

JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered on May 10, 1937. (R. 31.) Petition for certiorari was filed on August 5, 1937

(R. 32), and was granted on October 11, 1937 (R. 32). The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the petitioner's compensation as counsel for the Liquidation Bureau of the New York State Insurance Department, paid by the Bureau in the year 1932 out of the assets of the companies in liquidation, is subject to Federal income tax.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra*, pp. 34–35.

STATEMENT

The facts, as stipulated (R. 6–11) and as found by the Board of Tax Appeals (R. 13–17), are as follows:

The petitioner is an attorney at law. Prior to 1929 he was associated with a law firm in Brooklyn, New York, and was actively engaged in practice. In 1930 he was appointed by the Superintendent of Insurance of the State of New York to act as counsel in the Liquidation Bureau, a branch of the Insurance Department. He was employed there from the beginning of 1930 until August 2, 1933. During the year 1932 the Liquidation Bureau maintained three offices in New York City. The main office was in the New York State Building at

80 Center Street, where petitioner was employed during 1932, and there were two branch offices, one at 2 Lafayette Street and the other at 111 John Street, New York, New York. The petitioner gave full time required of employees in the Liquidation Bureau, and his hours were from 9 a. m. to 5 p. m., the same as other attaches of that Bureau. (R. 13–14.)

After severing connections with the law firm with which he was connected in 1929 petitioner received no further salary from the firm. He maintained office space in their offices and did a certain amount of personal legal work there, such as the preparation of wills, etc., all of which was accomplished out of his regular hours with the Liquidation Bureau. The members of the firm cooperated with him in handling his personal work and the fees received were divided according to agreement. Petitioner's personal legal fees in 1932 amounted to $1,410 and his office expenses were $570. The greater part of such sum represented fees from matters commenced in 1929, prior to his association with the Insurance Department. None of the personal legal work that he obtained after becoming associated with the Insurance Department was the result, either directly or indirectly, of his connection with that Department. (R. 14.)

The Liquidation Bureau was created in 1909 and is now known as the "Bureau of Liquidations, Conservations and Rehabilitations." This change in designation occurred some time in 1933 and was

made to make the name of the Bureau conform to the description of the title of Article II, Chapter 191, of the Insurance Laws of the State of New York, which went into effect on March 15, 1932. It will be hereinafter referred to as the Bureau. The Bureau was in the year 1932 and now is under the charge of a Special Deputy Superintendent of Insurance. The Special Deputy Superintendent is a Civil Service employee of the State of New York, and his salary is paid directly by the State. The Bureau also had in 1932 three assistant Special Deputy Superintendents, attorneys working on legal matters, bookkeepers, stenographers, adjusters and accountants. At the beginning of 1932 the Bureau had approximately 100 employees and at the end of 1932 the number had been increased to approximately 400, none of whom, with the exception of the Special Deputy Superintendent in charge, were Civil Service employees. The number of employees varied according to the number of insurance companies under the Bureau's jurisdiction. (R. 14.)

The general functions and duties of the Bureau are as follows: Under the Insurance Laws of the State of New York the Superintendent of Insurance of that State may, on certain grounds, apply to the judicial authorities of the State for an order directing him to take over the assets of insurers doing business, or in process of organization for the purpose of doing business in the State, for the purpose of liquidating, rehabilitating, or conserv-

ing the business of such insurers. Upon an order directing rehabilitation, liquidation, or conservation being granted, all of the work necessary to accomplish any of these results is performed by the Bureau. When an order is obtained directing the liquidation of an insurance company, its charter is dissolved and no new business is transacted. The work of liquidation consists of adjudicating the claims of the creditors of the company, selling the real estate and the other assets, and attempting to collect premiums due. After all of the assets of a company have been realized upon, dividends are distributed *pro rata* to the claimants entitled under the laws of the State of New York to participate in the assets of a defunct insurance company. When an order is obtained directing the rehabilitation of an insurance company, the Bureau actively operates it (but conducts no new business) and takes steps to remove the causes and conditions which made such proceeding necessary in an effort to bring about its rehabilitation and place the company in a sound financial condition. If the Bureau succeeds in rehabilitating the insurer, the assets are turned back to it and it resumes operations under its own direction. (R. 15.)

If and when it is determined that further efforts to rehabilitate a company will be futile, the Superintendent of Insurance may apply for an order of liquidation. No rehabilitation work was done by the petitioner or the Bureau in 1932. Although the Superintendent of Insurance was authorized to

apply for rehabilitation orders, no such order was applied for until the year 1933. Upon taking charge of a company for liquidation purposes, certain of the staff of the company, such as underwriters and the so-called "production staff", would be dismissed. The key employees would be retained, and the remainder dismissed as soon as practicable. It was the policy of the Bureau to centralize the liquidation work as much as possible in one office. The procedure would necessarily vary according to the size of the companies placed in liquidation, etc. In the case of a very large company its affairs could not be transferred to another office for a long period of time. At the beginning of 1932 the Bureau was liquidating 39 insurance companies; at the end of 1932 it was liquidating 11 companies. (R. 15–16.)

In legal matters involving companies in liquidation, the petitioner appeared as the attorney of record. He devoted over 90% of his time during 1932 to legal problems and cases involving the companies in liquidation whose affairs were being administered at the 80 Center Street office. The balance of his time was devoted to legal problems of the Bureau as a whole, such as the drafting of a new Article XI of the Insurance Law. (R. 16.)

In the year 1932 the Department of Insurance had a general bank account with the Bank of New York & Trust Company at 48 Wall Street, New York City. The expenses of the Bureau, including

all salaries, were paid by checks drawn on this bank. This account was referred to as the "Wash Account". Simultaneously with the drawing of checks for salaries, etc., other checks were drawn on the bank accounts of the companies in liquidation and deposited with the Bank of New York & Trust Company to equalize the amount drawn from the Wash Account to meet the salaries and other overhead expenses of the Bureau. In drawing checks against the various companies in liquidation to meet the petitioner's compensation, and the other expenses of the Bureau, checks would be drawn by an Assistant Special Deputy of Insurance (as representative of the Superintendent of Insurance) on the bank accounts in which the deposits of the various companies were maintained. Each company coming under the jurisdiction of the Bureau kept its separate bank account, and the Superintendent of Insurance (having charge of all the assets of such company) was in a position to draw checks on the account. (R. 16.)

Petitioner's compensation for 1932 was prorated to the companies in proportion to the time devoted to them by him in connection with the respective companies on the legal affairs of which he was engaged. Petitioner's time devoted to affairs of one particular company would be charged against such company. Petitioner's time devoted to the general legal problems of the Department would be prorated among the various companies under a

formula designed to charge general administration expenses of the Department to the companies in liquidation in proportion to the aggregate compensation of those engaged in the specific liquidation of the respective companies. (R. 16–17.)

Petitioner's compensation during 1932 was paid bimonthly by check, but was computed on an annual basis. Petitioner did not receive any additional compensation from the Insurance Department by way of special fees or otherwise in addition to his fixed compensation. His yearly compensation was determined by the Superintendent and the compensation did not vary in accordance with the volume of legal matters handled by him during the year. Petitioner's entire compensation for 1932 was paid from funds of insurance companies being liquidated by the Superintendent of Insurance. (R. 17.)

In the budget of the Superintendent of Insurance there appeared an item called the "reserve fund" for the use of the Superintendent in liquidating insurance companies whose assets were not sufficient to pay the cost of liquidation. In the budgets submitted for the fiscal years ending June 30, 1931, 1932, and 1933, the amount of the reserve fund was $5,000. It does not appear that any of the compensation paid to the petitioner during the year 1932 was derived from this fund. (R. 17.)

The petitioner in his income tax return for the taxable year 1932 reported a salary of $5,125 as

counsel for the Liquidation Bureau of the New York State Insurance Department, but claimed that it was exempt from Federal income tax (R. 23). The respondent, holding such salary not to be immune from Federal income tax, determined the deficiency here in question in the amount of $224.09 (R. 3). The Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit sustained the respondent's determination. (R. 18, 31.)

SUMMARY OF ARGUMENT

The only question in this case is whether the Federal Government may constitutionally tax petitioner's compensation as counsel for the Liquidation Bureau of the New York State Insurance Department. We submit that the decision of the court below must be affirmed because (1) petitioner's services were not rendered in connection with an essential governmental function, and (2) his compensation was paid from private rather than state funds. Our argument in this connection is fully developed in Points I and II (pp. 11–35) in *Helvering* v. *Therrell*, No. 128, October Term, 1937.

I

The regulation of insurance companies is an essential governmental function. Their operation is not. The liquidation of an insolvent company is not a state-wide regulatory activity, but merely the attempt economically to liquidate the assets

of a particular company for the sole benefit of those interested in its affairs.

II

The petitioner's compensation was paid out of the funds of the insolvent insurance companies in connection with the affairs of which he was engaged. (New York Insurance Law, Sec. 414, *infra.*) Since he is paid from private rather than State funds, a tax on his compensation contains no threat to the independence of the State government. Petitioner's contention that the immunity of the government employee is not based on a fear of affecting the public treasury leaves the doctrine without any reason to support its result. The only other reason which has been advanced by this Court, that a tax would reduce the compensation fixed by the other government, has been rejected in the case of the independent contractor. Our argument does not go to the point of taxing the fees by which certain officers are paid, since these fees, in distinction to the assets of the insolvent insurance companies, are the revenues of the State. Nor does our argument turn upon a question of bookkeeping: however the State might have arranged for petitioner's compensation, the fact remains that it did not choose to pay it out of State funds.

ARGUMENT

I

THE SERVICES OF THE PETITIONER WERE NOT IN CONNECTION WITH AN ESSENTIAL GOVERNMENTAL FUNCTION

The court below found it unnecessary to pass upon the nature of the power exercised by the State of New York in the liquidation of insolvent insurance companies and stated merely that "it may well be" that the petitioner's activities, like those of a receiver, were essential (R. 26). The respondent submits that in the liquidation of insolvent insurance companies the State of New York was not engaged in the exercise of an essential governmental function. In support of this view, the respondent, in the interests of brevity, adopts and incorporates herein by reference the argument presented under Point I (pp. 11–21) in the brief filed on behalf of the petitioner in *Helvering* v. *Therrell,* No. 128, October Term, 1937. The remainder of this argument will be directed toward considerations particularly applicable to the liquidation of insurance companies by the State of New York and to the arguments advanced by petitioner.

Here, as in the *Therrell* case (Govt. Br. 12), we readily concede that the *regulation* of insurance companies is an essential governmental function.

We have, therefore, no quarrel with petitioner (Br. 10–12) on this score. Similarly, petitioner appears to concede, in his distinction of the "proprietary" cases (Br. 12), that the *operation* of an insurance company would not be an essential governmental function. So here, as in the *Therrell* case, the issue is narrowed to whether or not the liquidation of insolvent insurance companies is more akin to their operation or to their regulation.

Petitioner demonstrates (Br. 13–15) that the State has a legitimate and important interest in the liquidation of insolvent insurance companies. With this we are in complete accord. The obvious purpose of the statutes under which the Liquidation Bureau functioned was to substitute an economical liquidation of insolvent insurance companies by the State in place of the receiverships which had in the past proved extravagant and wasteful. See *In re Russian Reinsurance Co. of Petrograd, Russia,* 223 A. D. 378; *Van Tuyl* v. *Scharmann,* 208 N. Y. 53, 63. The State, of course, had the power to levy taxes for the purpose of maintaining such regulation. *In re Bond & Mortgage Guarantee Co.,* 283 N. Y. S. 623, 626. This, however, is far from establishing that the activity was an essential governmental function, such that federal taxation of the salaries of those engaged in the liquidation threatens the independence of the State government. See *Helvering* v. *Powers,* 293 U. S. 214, 225. New York State in the years prior to 1909 was a sovereign and independent state

without any form of administrative liquidation of insolvent insurance companies. The legislation which established the Liquidation Bureau was a notable recognition of the responsibility of the State in providing an efficient means to salvage the investments of policyholders and creditors. But the very date of its enactment shows that its abandonment would not mean that "in a very real sense" the State "itself would then disappear." *Brush* v. *Commissioner*, 300 U. S. 352, 371.

This becomes plain when it is considered that the Liquidation Bureau does not operate to enforce State-wide regulatory measures, nor to prescribe rules for the safe conduct of the insurance business generally. It serves only to liquidate efficiently the assets of a particular insurer, in order to make as large a return as possible to the policyholders, creditors and stockholders of that particular company (New York Insurance Law, Sec. 426, *infra*). The Superintendent is vested by operation of law with title to the property and the contracts of the insurer; the order of liquidation must direct him to "deal with the property and business of such insurer" in his own name or that of the insurer (Sec. 404, *infra*). The expenses of the liquidation are paid out of the funds of the insurer (Sec. 414, *infra*). The Superintendent borrows any necessary funds not through the State but on pledge of the assets of the insurer (Sec. 421a, *infra*).

Thus, the status of the Superintendent when functioning as the liquidator or rehabilitator of

insolvent insurance companies is essentially that of a receiver.[1] *Conway* v. *North Side Lumber Co.*, 252 N. Y. S. 476; *Jacoby* v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420 (C. C. A. 2d); *Tolfree* v. *New York Title & Mortgage Co.*, 72 F. (2d) 702 (C. C. A. 2d). His liquidation activities, as those of any receiver, are directed toward the benefit of the particular persons interested in a particular business enterprise. The success or failure of the liquidation has no appreciable effect upon the conduct of solvent insurers, nor on the citizens of the State generally. In liquidation, as in operation, the business may be "affected with a public interest." But in neither case is the pecuniary success of the activity a matter of concern to any but the interested parties. And there is no goal other than the pecuniary one. Liquidation, as operation, remains essentially a private enterprise conducted for profit (or minimization of loss).[2] It is not a

[1] As such, the corporate assets of the insolvent insurance companies are in his hands in *custodia legis* and subject to judicial control except in matters as to which the statute vests the Superintendent with discretionary powers. *Matter of People (Tit. & Mtge. Guar. Co.)*, 264 N. Y. 69.

[2] It is true that the enterprise is a favored one. Its affairs are subject to judicial supervision. It is subject to suit only in the court which has jurisdiction and is immune to subsequent liens or execution of judgment (Sec. 410, *infra*). The Superintendent may subpoena and examine persons and records (Sec. 415, *infra*). It is exempt from filing and recording fees (Sec. 416, *infra*) and its deposits are entitled to priority (Sec. 417, *infra*). But it remains an activity on behalf of those interested in a particular insurer, and is not governmental regulation.

matter of *governmental* concern of a magnitude such that it is essential to the independence of the State.

It may be suggested that an orderly liquidation is merely an aspect of regulation. We do not deny its close relationship. But this relationship is precisely that which obtains between the operation and the regulation of insurance companies. We know of no reason for State liquidation—whether it be maintenance of confidence in insurance companies generally, or aiding the policyholders and creditors of a given insurer—which is not fully applicable to State operation of going insurers. And there is no contention that a state operated insurance company would be an essential governmental function such as to be exempt from federal taxation. See *State of North Dakota* v. *Olson,* 33 F. (2d) 848 (C. C. A. 8th), appeal dismissed for want of jurisdiction, 280 U. S. 528; 2 Cooley on Taxation (4th ed.), Sec. 639.

II

A TAX ON COMPENSATION PAID FROM PRIVATE FUNDS CONTAINS NO THREAT TO THE DUAL SYSTEM OF GOVERNMENT

The respondent adopts and incorporates herein by reference the argument made in the petitioner's brief under Point II (pp. 21–35) in *Helvering* v. *Therrell,* No. 128, October Term, 1937, in support of this proposition. In this brief we shall indicate the matters relevant to the compensation paid

those engaged in liquidating New York insurance companies and discuss certain contentions of the petitioner.

1. Section 414 of the New York Insurance Law, *infra,* provides that "the compensation of such special deputy superintendents, counsel, clerks and assistants, and all expenses of conducting any proceeding under this article shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such insurer." Petitioner's compensation was prorated among the insolvent companies in proportion to the time he spent on the affairs of each, and the 10 per cent of his time devoted to general problems of the Department was prorated among all the insolvent companies by formula. Payments were made out of the "Wash Account", which in turn was credited with drafts in appropriate amounts upon the accounts of the particular insolvent companies in question. (R. 16–17.)

Thus it is evident that petitioner, as the respondent in the *Therrell* case, is paid from private rather than State funds. A federal tax on his compensation accordingly contains no possibility of endangering our dual system. Such was the decision of this Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107, 174.

2. Petitioner argues (Br. 22–24) that the effect of the federal tax upon the state treasury is material only in connection with independent contractors

and with transactions but indirectly related to the state function. To buttress this view he renounces as "purely guess work" any presumption that income taxes upon government employees, which "are paid out of the pockets of the individual taxpayers", are reflected in the state treasury (Br. 24, 23).

In the first place, petitioner's position makes the exemption of the salaries of officers and employees a matter more of fiat than of reason. The government employee is a private person. He pays property taxes and excise taxes. He is, however, exempted from paying an income tax upon his government salary. We think it evident that the Circuit Court of Appeals for the Second Circuit was right in saying that there can be no rational reason for this single immunity other than the belief that this tax will be reflected in the state treasury (*Harman* v. *Helvering,* 90 F. (2d) 622, 623). If it were thought that an income tax on the salary of a government employee could not affect the sovereign there would be no reason for the exemption. We submit that petitioner cannot at once claim the protection of the employee's tax immunity and reject the reason upon which it is based.

In the second place, petitioner mistakes the opinions of this Court in the cases which have declared exempt the salaries of government employees. So far as we can determine there have been only four cases in which this question has been decided. In *Brush* v. *Commissioner,* 300 U. S. 352,

and *New York ex rel. Rogers* v. *Graves,* 299 U. S. 401, the Court did not spell out the reason for the employee's immunity, but relied upon earlier decisions. In *Collector* v. *Day,* 11 Wall. 113, the Court, apart from general expressions to the effect that an instrumentality of government could not be taxed, relied upon *Dobbins* v. *Commissioners,* 16 Pet. 435, and devoted the bulk of its opinion to the proposition that the immunity of federal instrumentalities was equally applicable to state instrumentalities. This leaves *Dobbins* v. *Commissioners* as the only case in which this Court has ever sought as a ground of decision to explain the immunity from income tax which is granted to government employees.[3] The basis of this decision was twofold. The Court first argued that the Congress might have to increase the compensation of the captain in consequence of the tax. It said (16 Pet. at 448):

> Is not compensation the means by which his services are procured and retained? It is true, it becomes his, when he has earned it. If it can be taxed by a state, as compensation, will not congress have to graduate its amount with reference to its reduction by

[3] The case, strictly, is not one of an income tax. The Commissioners of Erie County imposed a property tax of $10.75 on the *office* of a captain of a United States revenue cutter, which was valued at $500 (16 Pet. at 444). But the assessors were directed "to rate all offices and posts of profit * * * having a due regard to the profits arising therefrom." (16 Pet. at 445.)

> the tax? Could congress use an uncontrolled discretion in fixing the amount of compensation, as it would do, without the interference of such a tax? * * *

The Court then advanced as a second ground the fact that the tax would diminish the compensation which had been fixed by Congress. It said (pp. 449–450):

> The compensation of an officer of the United States is fixed by a law made by congress. * * * Does not a tax, then, by a state upon the office, diminishing the recompense, conflict with the law of the United States, which secures it to the officer in its entireness?

Of the two grounds of decision in *Dobbins* v. *Commissioners,* the second has, we believe, indisputably been rejected by this Court. A tax on the net income of an independent contractor diminishes the compensation fixed by the government with whom he contracts. Yet it is settled that such a tax is valid. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514. So, too, may the gross receipts of the contractor be diminished by the amount of a state gross receipts tax. *James* v. *Dravo Contracting Co.,* No. 3, October Term, 1937; cf. *Alward* v. *Johnson,* 282 U. S. 509; *Liggett & Myers Co.* v. *United States,* 299 U. S. 383; *Fidelity & Deposit Co.* v. *Pennsylvania,* 240 U. S. 319. And none has ever supposed, when the state fixes the rates of a public utility so as to give a fair return upon its

property, that the utility acquires an immunity to federal taxation.

This leaves the first ground of the decision in *Dobbins* v. *Commissioners* as the only reason, which has been advanced and not subsequently rejected, for the immunity of the government employee from taxation by the other sovereign. This reason is the fear that the employing government, in paying the compensation, would "have to graduate its amount with reference to its reduction by the tax." Coupled with the belief that the power to tax is the power to destroy, it has resulted in the tax immunity of employees paid out of the government funds. But its reasoning is obviously inapplicable to employees paid out of private funds. And, as this Court has frequently pointed out, the doctrine of tax immunity is limited by its reason. *National Bank* v. *Commonwealth,* 9 Wall. 353, 362; *Board of Trustees* v. *United States,* 289 U. S. 48, 59; *Helvering* v. *Powers,* 293 U. S. 214, 224–225. *Indian Territory Oil Co.* v. *Board,* 288 U. S. 325, 328; *Metcalf & Eddy* v. *Mitchell, supra,* 523.

3. Petitioner states (Br. 25) that our position "would create a wholly unwarranted distinction between state paid salaries and the fee system." He then argues (Br. 25–28) that many state officers are paid by fees and should share the immunity of those paid by salaries. We agree that the officer paid by fees should have the immunity of those

paid a salary. We deny that our position requires a distinction. As pointed out in our brief in the *Therrell* case (pp. 31–32), the fees are a part of the State revenues and the officer's compensation is paid by the State just as fully as though he transmitted the entire amount to the State treasury and received from the State an amount corresponding to the designated amount or percentage. But in petitioner's case he is paid not out of state revenues but from private funds. Whether he receives a greater or smaller amount in no manner affects the state revenues, but is of interest only to the policyholders, creditors and stockholders of the company with whose affairs he is engaged.

4. Petitioner suggests (Br. 32) that our argument makes tax exemption turn upon what is merely a matter of bookkeeping. But it is obviously more than a matter of form whether or not the State or the insolvent company pays the expenses of liquidation. The New York Insurance Law itself makes the distinction, by requiring, in Section 7, that the actual expenses of examination be paid into the Treasury by solvent insurers, while the expenses of liquidation are paid directly out of the funds of the insolvent company (Sec. 414, *infra*). This points the obvious difference between state and private payment. To take a simple example, the state might require the adjoining owner to improve the road in front of his property; alternatively, the same result could be

reached if the state were itself to improve the road and levy a special assessment on adjoining property owners to recoup the cost. Yet none doubts but that the tax immunity which is supposed to attach to the compensation of the laborer hired by the state would not remain if he were hired instead by the property owner to do the same work. The mere fact that the state might, if it chose, make the payments itself does not carry the immunity of such payments over into the situation where the state is not in fact making the payments.

It should further be noted that even if this basic distinction were not present, and if tax immunity did in fact turn on bookkeeping alone, our argument would not thereby be disproved. Many "close distinctions" have been observed "in this difficult field." *James* v. *Dravo Contracting Co. supra* (pamph. pp. 11, 13). The broad doctrine that government employees and officers are tax exempt on their compensation could not otherwise be applied "without unduly limiting the taxing power which is equally essential to both nation and state under our dual system." *James* v. *Dravo Contracting Co., supra* (pamph. p. 11).

5. Finally, the petitioner's contention that the imposition of a Federal income tax on the petitioner's compensation would necessarily restrict the State of New York in the performance of its functions of liquidating insolvent insurance companies (Br. 29–31, 33–34) is predicated on the assertion that if such tax may be constitutionally im-

posed the petitioner's "compensation can be reduced to the vanishing point" and the ability of the State of New York to function thus be destroyed. The argument ignores the nature of the tax, which, unlike that in *Veazie Bank* v. *Fenno*, 8 Wall. 533, is non-discriminatory in nature.

CONCLUSION

The tax in question is not forbidden by the implication of the Constitution, in that it is imposed (1) with respect to an activity which is not an essential governmental function, and (2) on compensation derived from private rather than state funds. Either of these considerations is sufficient to support the determination of the Commissioner and the decisions of the Board of Tax Appeals and the Circuit Court of Appeals. The judgment of the court below should, therefore, be affirmed.

Respectfully submitted.

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DECEMBER, 1937.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, * * *.

Treasury Regulations 77:

ART. 643. *Compensation of State officers and employees.*—Compensation paid to its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision, including fees received by notaries public commissioned by States, is not taxable. Compensation received for services rendered to a State or political subdivision thereof is included in gross income unless (a) the person receives such compensation as an officer or employee of a State or political subdivision, and (b) the services are rendered in connection with the exercise of an essential governmental function. The commissions of receivers appointed by State courts are taxable.

* * * * *

New York Insurance Law (McKinney's Consolidated Statutes, Book 27):

SEC. 401. *Grounds for rehabilitation of domestic insurer.*—The superintendent may

apply under this article for an order directing him to rehabilitate a domestic insurer upon any one or more of the following grounds: that such insurer (a) is insolvent; or (b) has refused to submit its books, papers, accounts or affairs to the reasonable inspection of the superintendent or his deputy or examiner; or (c) has neglected or refused to observe an order of the superintendent to make good within the time prescribed by law any deficiency, whenever its capital, if it be a stock corporation, or its reserve, if it be a mutual corporation, shall have become impaired; or (b) has, by contract of reinsurance or otherwise, transferred or attempted to transfer substantially its entire property or business, or entered into any transaction the effect of which is to merge substantially its entire property or business in the property or business of any other corporation, association, society, order, partnership or individual, without having first obtained the written approval of the superintendent; or (e) is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policyholders, or to its creditors, or to the public; or (f) has wilfully violated its charter or any law of the state; or (g) has an officer who has refused to be examined under oath, touching its affairs; or (h) if organized under article five-a, six, seven, eight, ten-a or ten-b of this chapter is found to be in such condition, after examination, that it could not meet the requirements for incorporation and authorization specified in such articles respectively; or (i) has ceased to transact the business of insurance for a period of one

year; or (j) has commenced voluntary liquidation or dissolution, or attempts to commence or prosecute any action or proceeding to liquidate its business or affairs, or to dissolve its corporate charter, or to procure the appointment of a receiver, custodian, or sequestrator under any law except this article; or (k) has been the subject of an application for the appointment of a receiver, custodian or sequestrator of the insurer or its property, or if a receiver, custodian or sequestrator, is appointed by a federal court or such appointment is imminent; or (l) has consented through a majority of its directors, stockholders, or members; or (m) has not organized and obtained a certificate authorizing it to commence the transaction of its business within one year from the date of its incorporation as provided for in section sixty-six-a of this chapter.

SEC. 402. *Order of rehabilitation; termination.*—1. An order to rehabilitate a domestic insurer shall direct the superintendent and/or his successors in office forthwith to take possession of the property of such insurer and to conduct the business thereof, and/or to take such steps toward the removal of the causes and conditions which have made such proceeding necessary as the court shall direct.

2. At any time the superintendent shall deem that further efforts to rehabilitate such insurer would be futile, he may apply to the court under this article for an order of liquidation.

3. The superintendent, or any interested person upon due notice to the superintendent, at any time, may apply for an order terminating this proceeding and permitting

such insurer to resume possession of its property and the conduct of its business, but no such order shall be granted except when, after a full hearing, the court shall determine that the purposes of the proceeding have been fully accomplished.

SEC. 403. *Grounds for liquidation of domestic insurer.*—The superintendent may apply, under this article, for an order, directing him to liquidate the business of a domestic insurer upon any one or more of the grounds specified in section four hundred and one of this chapter, regardless of whether or not there has been a prior order directing him to rehabilitate such insurer.

SEC. 404. *Order of liquidation; rights and liabilities.*—1. An order to liquidate the business of a domestic insurer shall direct the superintendent and/or his successors in office forthwith to take possession of the property of such insurer and to liquidate the business of the same and to deal with the property and business of such insurer in their own names as superintendents or in the name of the insurer as the court or justice before whom such order is returnable may direct, and to give notice to all creditors who may have claims against such insurers to present the same.

2. The superintendent and/or his successors shall be vested by operation of law with the title to all of the property, contracts, and rights of action of such insurer as of the date of the order so directing them to liquidate. The filing or recording of such order in any record office of the state shall impart the same notice that a deed, bill of sale, or other evidence of title duly filed or recorded by such insurer would have imparted. The rights and liabilities of any such insurer and of its creditors, policyholders, stockholders,

members, and/or all other persons interested in its estate shall, unless otherwise directed by the court, be fixed as of the date of the entry of the order directing the liquidation of such insurer in the office of the clerk of the county where such insurer had its principal office for the transaction of business upon the date of the institution of proceedings under this article. Provided, however, that the right of claimants holding contingent claims on said date to share in an insolvent estate shall be determined by section four hundred and twenty-five of this chapter.

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SEC. 407. *Grounds for dissolution of domestic insurer.* — The superintendent may apply under this article for an order dissolving the corporate existence of a domestic insurer; (a) upon his application for an order of liquidation of the business of such insurer, or at any time after such an order has been granted; or (b) upon the grounds specified in section four hundred and one, subdivision (m) of this chapter, regardless of whether an order of liquidation is sought or has been obtained.

SEC. 408. *Commencement of a proceeding.* — The superintendent, the attorney-general representing him, shall commence any proceeding under this article by an application to the supreme court, or to any justice thereof, in the judicial district in which the principal office of the insurer involved is located, for an order directing such insurer to show cause why the superintendent should not have the relief prayed for. On the return of such order to show cause, and after a full hearing, which shall be held by the court or justice without delay, such court, or justice shall either deny the application or

grant the same together with such other relief as the nature of the case and the interests of policyholders, creditors, stockholders, members, and/or the public may require.

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SEC. 410. *Injunctions.*—1. Upon an application by the superintendent for an order to show cause under this article, or at any time thereafter, the court in which such order is made, or any justice thereof may, without notice, issue an injunction restraining the insurer named in the order, its officers, directors, stockholders, members, trustees, agents, servants, employees, policyholders, attorneys, managers, and/or all other persons from the transaction of its business or the waste or disposition of its property until the further order of the court.

2. Such court or justice may at any time during a proceeding under this article issue such other injunctions or orders as may be deemed necessary to prevent interference with the superintendent or the proceeding, or waste of the assets of the insurer, or the prosecution of any actions, or the obtaining of preferences, judgments, attachments or other liens, or the making of any levy against the corporation or against its assets or any part thereof.

SEC. 411. *Annual report.*—The superintendent shall transmit to the legislature in his annual report, the names of all insurers proceeded against under this article together with such facts as shall acquaint the policyholders, creditors, stockholders, and/or the public with all proceedings. To that end the special deputy superintendent in charge of any such insurer shall file annually with the superintendent a report of the affairs of such insurer.

SEC. 412. *Removal of proceedings to Albany.*—At any time after the commencement of a proceeding under this article, the superintendent may remove the principal office of the insurer to the county of Albany. In the event of such removal, the court shall, upon the application of the superintendent, direct the clerk of the county wherein such proceeding was commenced, to transmit all of the papers filed therein with such clerk to the clerk of the county of Albany and the proceeding shall thereafter be conducted in the same manner as though it had been commenced in the county of Albany.

SEC. 413. *Rules.*—For the purpose of this article, the superintendent shall have the power, subject to the approval of the court, to make and prescribe such rules and regulations as to him shall seem proper.

SEC. 414. *Appointment of deputies; employment of assistants; payment of salaries and expenses.*—1. For the purposes of this article the superintendent shall have power to appoint under his hand and official seal, one or more special deputy superintendents of insurance, as his agent or agents, and to employ such counsel, clerks, and assistants as may by him be deemed necessary, and to give each of such persons such powers to assist him as he may consider wise.

2. The compensation of such special deputy superintendents, counsel, clerks, and assistants, and all expenses of conducting any proceeding under this article shall be fixed by the superintendent, subject to the approval of the court, and shall, on certificate of the superintendent, be paid out of the funds or assets of such insurer.

SEC. 415. *Examinations; misdemeanors thereon; immunity; penalty for refusal to be examined.*—1. At any time during the

progress of any proceeding taken under this article, the superintendent shall have power either personally or by his deputies, including his special deputy superintendents or examiners to subpoena witnesses, to compel their attendance, to administer an oath, and to examine any person under oath, before him, or before a deputy or examiner duly designated for such purpose, and in connection therewith to require the production of any books or papers relevant to the inquiry. If a person subpoenaed to attend such inquiry fails to obey the command of a subpoena without reasonable excuse, or if a person in attendance upon such inquiry, shall, without reasonable cause, refuse to be sworn, or to be examined, or to answer a question, or to produce a book or paper when ordered to do so by the officer duly conducting such inquiry, or if a corporation, association, partnership, or individual fails to perform any act required hereunder to be performed, he shall be guilty of a misdemeanor, and, in addition thereto, compliance with the above provisions may be imposed pursuant to section four hundred and six of the civil practice act. Any officer participating in such inquiry and any person examined as a witness upon such inquiry who shall disclose to any person, other than the superintendent, the name of any witness examined or any other information obtained upon such inquiry, except as directed by the superintendent, shall be guilty of a misdemeanor.

2. If any person shall ask to be excused from testifying or producing any book or paper or other document before the superintendent or before any person duly designated by him to conduct any such investigation upon the ground or for the reason that the testimony or evidence, documentary or

otherwise, required of him may tend to incriminate him or degrade him or to subject him to a penalty or forfeiture, and shall notwithstanding be directed by the superintendent or by the person duly designated by the superintendent to conduct any such inquiry to testify or to produce such book, paper, or document, he must none the less comply with such direction but in such event he shall not thereafter be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he may testify or produce evidence, documentary or otherwise, pursuant thereto and no testimony so given or produced shall be received against him upon any criminal action, suit or proceeding, investigation, inquisition, or inquiry. Provided, however, no person so testifying shall be exempt from prosecution or punishment for any perjury or other false statement committed or made by him in his testimony given as herein provided for.

3. Any individual, co-partnership, unincorporated association, or corporation which refuses to permit examination or investigation in accordance with the terms of this section shall forfeit to the people of the state the sum of two hundred dollars for every day, after the date of such refusal, that such individual, co-partnership, unincorporated association, or corporation continues to refuse to permit such examination or investigation.

SEC. 416. *Exemption from filing fees.*— The superintendent shall not be required to pay any fee to any public officer for filing, recording, or in any manner authenticating any paper or instrument relating to any proceeding under this article.

SEC. 417. *Deposit of monies collected; preference.*—The monies collected by the superintendent in a proceeding under this article shall be, from time to time, deposited in one or more state or national banks, savings banks, or trust companies, and in the case of the insolvency or voluntary or involuntary liquidation of the depositary, such deposits shall be entitled to priority of payment on an equality with any other priority given by the banking law; or such moneys may be deposited in a national bank or trust company as a trust fund.

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SEC. 421. *Sale or other disposition of assets and compromise of claims.*—The superintendent may, subject to the approval of the court, (a) sell or otherwise dispose of the real and personal property, or any part thereof, of an insurer against whom a proceeding has been brought under this article and (b) sell or compound all doubtful or uncollectible debts or claims owed by or owing to such insurer including claims based upon an assessment levied against a member of a mutual insurer, provided that whenever the amount of any such debt or claim owed by or owing to such insurer does not exceed two hundred dollars, the superintendent may compromise or compound the same upon such terms as he may deem for the best interests of said insurer without obtaining the approval of the court.

SEC. 421-a. *Borrowing on the pledge of assets.*—For the purpose of facilitating the rehabilitation, liquidation, conservation, or dissolution provided for by this article the superintendent may, subject to the approval of the court, borrow money and execute, acknowledge, and deliver notes or other evidences of indebtedness therefor and se-

cure the repayment of the same by the mortgage, pledge, assignment, transfer in trust, or hypothecation of any or all of the property whether real, personal, or mixed of an insurer against whom a proceeding has been brought under this article and the superintendent, subject to the approval of the court, shall have power to take any and all other action necessary and proper to consummate any such loans and to provide for the repayment thereof. The superintendent shall be under no obligation personally or in his official capacity as superintendent of insurance to repay any loan made pursuant to this section.

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SEC. 426. *Distribution of assets; priorities; unclaimed dividends.*—1. Any time after the last day fixed for the filing of proofs of claim in the liquidation of a domestic insurer, the court may, upon the application of the superintendent, authorize him to declare out of the funds remaining in his hands after the payment of expenses one or more dividends. Such order shall specify what claims, if any, are entitled to priority of payment and shall direct the manner in which dividends shall be paid. (a) Where there has been no adjudication of insolvency, the superintendent shall pay all allowed claims in full and shall distribute the balance of the assets remaining in his hands in accordance with the direction of the court. The superintendent shall not be chargeable for any assets so distributed to any claimant who has failed to file a proper proof of claim before such distribution has been made. (b) Where there has been an adjudication of insolvency pursuant to section four hundred and twenty-four of this chapter and there is a surplus, after a re-

serve has been set up for the payment in full of all claims which have been duly filed prior to the last day fixed for the filing thereof, when and if such claims shall have been allowed, the solvency of such insurer shall be re-examined and if such insurer is then found to be clearly solvent, the surplus shall be distributed as though no order under section four hundred and twenty-four of this chapter had been made. If, however, the solvency of such insurer still is not clear, the court shall set a new date for the filing of claims under said section four hundred and twenty-four. A second distribution shall be made upon the expiration of that period after the manner of the first distribution including the disposition of any further surplus, which procedure shall be repeated as often as may be necessary.

2. Dividends remaining unclaimed or unpaid in the hands of the superintendent for six months after the final order of distribution may be by him deposited in one or more state or national banks, trust companies, or savings banks to the credit of the superintendent of insurance, whosoever he may be, in trust for the person entitled thereto. All such deposits shall be entitled to priority of payment in case of the insolvency or voluntary or involuntary liquidation of the depository on an equality with any other priority given by the banking law.

Prior to March 15, 1932, liquidation proceedings were undertaken by the Superintendent under the authority of Laws of 1909, ch. 300, as amended (Section 63 of Insurance Law). Except that there was no provision for rehabilitation proceedings, the procedure was the substantial equivalent of the more elaborate system enacted in 1932 (L. 1932 ch. 191).

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